Eksportfinans faces collateral questions following downgrade

Dealers are concerned the downgrade of Norwegian lender Eksportfinans – which is being replaced by a new state-backed entity – means it will not be able to continue collateralising its large derivatives portfolio, and say counterparties will back away from the export lender as a result. The company will not make new loans while it is being wound up, but its existing derivatives will remain in place while outstanding loans mature, and the company says it intends to manage that portfolio actively.

"Eksportfinans will be much more restricted in counterparties now," says the head of one European bank's sovereign, supranational and agencies (SSA) desk. "If new transactions reduce the expected exposure of our overall portfolio then we might consider it, but if it was a risk-additive trade I think it's unlikely banks would want to do that, because the uncertainties are so enormous with that counterparty."

Eksportfinans was downgraded to Ba1 from Aa3 by Moody's Investors Service on November 22, some weeks after a decision by Norway's finance ministry not to grant it a permanent exemption from the European Union's Capital Requirements Directive (CRD), which limits single exposures to 25% of a lender's regulatory capital. Eksportfinans has five loans that will exceed the CRD limit when its current exemption expires on December 31, 2012.

These events have sparked confusion among Eksportfinans bondholders, but the company's dealers are also facing an uncertain future. As of the end of last year, the lender had a derivatives portfolio worth a notional Nkr432.8 billion ($74.5 billion) according to its annual report – with more than a third of that made up of interest rate derivatives. Dealers say the low-rate environment means Eksportfinans is in the money, and is therefore receiving collateral, but its counterparties are already worried about what will happen when rates rise.

"If the mark-to-market moves significantly and it has to come up with a lot of collateral, I don't know where it is going to get it from. At the moment it is excluded from the bond market," says the SSA desk head.

Eksportfinans had not responded to requests for comment by press time, but during a conference call with investors on November 28, the company claimed its liquidity reserve portfolio would enable it to meet all outstanding obligations during the wind-up period. Nonetheless, dealers are not convinced.

"We know it has this liquidity portfolio that if needed it could potentially dismantle to meet its obligations, but swaps move on a continuous basis so the pressing question is whether it has sufficient funds to meet liquidity postings that are going to come up over time, and that is still very much up in the air," says a fixed-income specialist at one US bank.

Separately, dealers are also unhappy the entity replacing Eksportfinans plans not to use derivatives. Sigurd Klakeg, deputy director-general at the Ministry of Finance in Oslo, says: "As to currency and interest rate exposure, the government will take an outright risk – it will not enter into a swap or other derivatives transaction to hedge its position in individual transactions."

As a result, dealers will not be able to look to the new entity as a way of replacing business lost during the demise of Eksportfinans. "Everyone's lost an important counterparty in the fixed-income world when it comes to structured notes and benchmark transactions," says one dealer.

Joe Rennison

Swaps push-out repeal unlikely to pass Congress

A move to repeal section 716 of the Dodd-Frank Act – the requirement that banks push their equity, commodity and uncleared derivatives into separate affiliates – is unlikely to make its way through the US Congress despite being approved in a November 15 vote by a subcommittee of the House Committee on Financial Services, lawyers say.

"I certainly don't hold out a lot of hope for the bill's passage because it has to go through the Senate, which is still controlled by the Democrats. However, it does a couple of things: it lays out a position, so that the majority party in the House can express what they would do if they had control of the process, and it requires the Democrats to reaffirm their policy on the swaps push-out," says Don Lamson, counsel at Shearman & Sterling in Washington, DC.

Don Lamson, Shearman & Sterling

The bill, H.R. 1838, which was introduced by congresswoman Nan Hayworth on May 11, was marked up by the Committee on Financial Services' subcommittee on capital markets and government sponsored entities on November 15 by a vote of 21 to 12 – with two Democrats, Carolyn Maloney and Jim Himes, voting with the Republicans.

However, for the bill to progress, the House Committee on Agriculture would have to produce a similar bill before it hit the floor of the House of Representatives, and the Senate would also have to produce a comparable bill. "There is a fear that if any part of Dodd-Frank is reopened even to fix the non-controversial problems, then other, more controversial, provisions will be reopened for debate and possible amendment, which neither side necessarily wants," says Scott Cammarn, special counsel at Cadwalader, Wickersham & Taft in Charlotte.

Matt Cameron